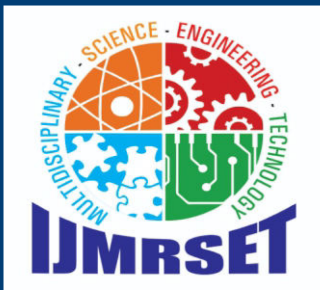

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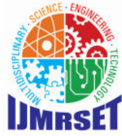

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Reforms in Indian Banking Sector

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ABSTRACT: As the economy grows and becomes more sophisticated, the banking sector has to develop pari pasu in a manner that it supports and stimulates such growth. With increasing global integration, the Indian banking system and financial system has as a whole had to be strengthened so as to be able to compete. India has had more than a decade of financial sector reforms during which there has been substantial transformation and liberalisation of the whole financial system. It is, therefore, an appropriate time to take stock and assess the efficacy of our approach. It is useful to evaluate how the financial system has performed in an objective quantitative manner. This is important because India's path of reforms has been different from most other emerging market economies: it has been a measured, gradual, cautious, and steady process, devoid of many flourishes that could be observed in other countries. Until the beginning of the 1990s, the state of the financial sector in India could be described as a classic example of "financial repression" a la MacKinnon and Shaw. The sector was characterised, inter alia, by administered interest rates, large pre-emption of resources by the authorities and extensive micro-regulations directing the major portion of the flow of funds to and from financial intermediaries. While the true health of financial intermediaries, most of them public sector entities, was masked by relatively opaque accounting norms and limited disclosure, there were general concerns about their viability. Insurance companies – both life and non-life - were all publicly owned and offered very little product choice. In the securities market, new equity issues were governed by a plethora of complex regulations and extensive restrictions.

KEYWORDS: financial, banking, sector, reforms, restrictions, sophisticated, Indian, liberalization, viability

I. INTRODUCTION

In the context of economic liberalisation and growing trend towards globalisation (external liberalisation), various banking sector reforms have been introduced in India to improve the operation efficiency and upgrade the health and financial soundness of banks so that Indian banks can meet internationally accepted standards of performance.

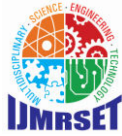
Reforms in the banking sector were introduced on the basis of the recommendations of different committees:
(i) The first Narasimhan Committee (1991),

(ii) The Verma Committee (1996),

(iii) The Khan Committee (1997), and

(iv) The Second Narasimhan Committee (1998).[1,2]

The First Phase of Reforms:
The banking sector reforms are directed toward improving the policy framework, financial health and the institutional framework:
(a) Change in Policy Framework:
Improvement in policy framework has been undertaken by reducing the Cash Reserve Ratio (CRR) to the initial standard and phasing out Statutory Liquidity Ratio (SLR), deregulation of interest rates, widening the scope of lending to priority sectors and by linking the lending rates to the size of advances.



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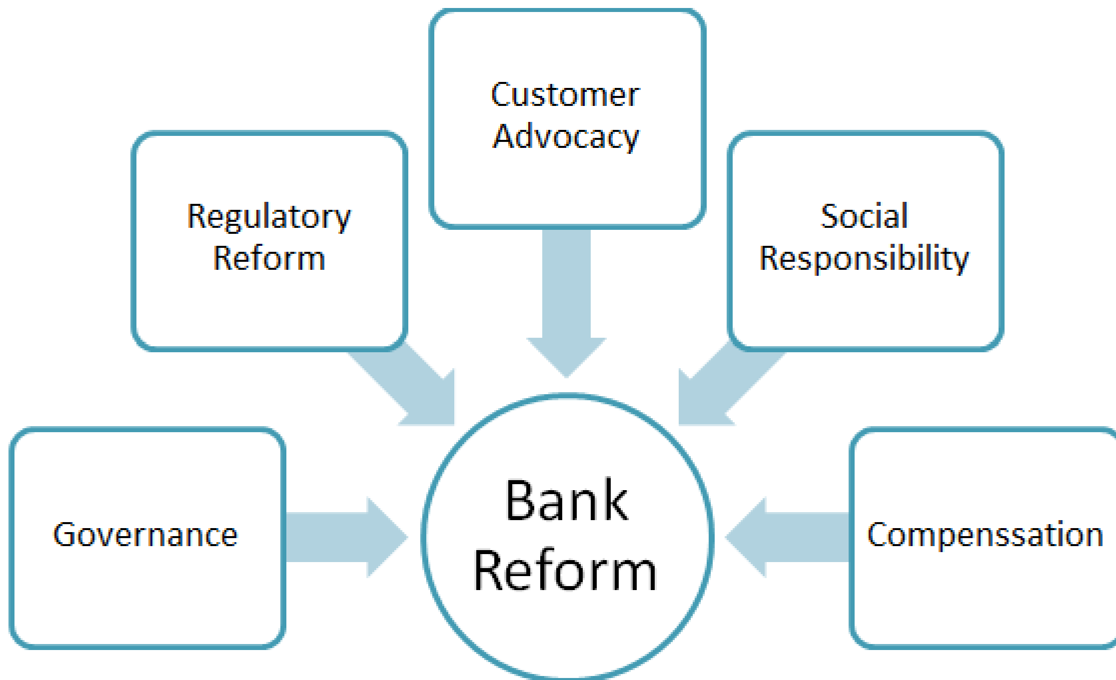


(b) Improving Financial Health:
Attempts to improve the financial soundness of the banking sector have been made by prescribing prudential norms. Moreover, steps have been taken to re-duct the proportion of Non-Performing Assets (NPAs).

(c) Improvements of Institutional Framework:
Such improvements have been achieved in three ways:
(i) Recapitalisation,

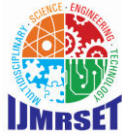
(ii) Creating a competitive environment, and

(iii) Strengthening the supervisory system.[3,4]

Second Phase Reforms:
The first phase of the bank sector reforms is completed. The second generation reforms which are underway concentrate on strengthening the very foundation of the banking system in three ways: by reforming the structure of the bank industry, technological upgradation, and humaning resource development.

Prudential Regulation:
There are two types of banking regulations—economic and prudential. In the pre-reform era (before July 1991) the Reserve Bank of India (RBI) regulated banks by imposing constraints on interest rates, tightening entry norms and directed lending to ensure judicious end use of bank credit.

However, such economic regulation of banks hampered their productivity and efficiency. Hence, the RBI switched over to prudential regulation which calls for imposing minimum limit on the capital level(s) of banks.



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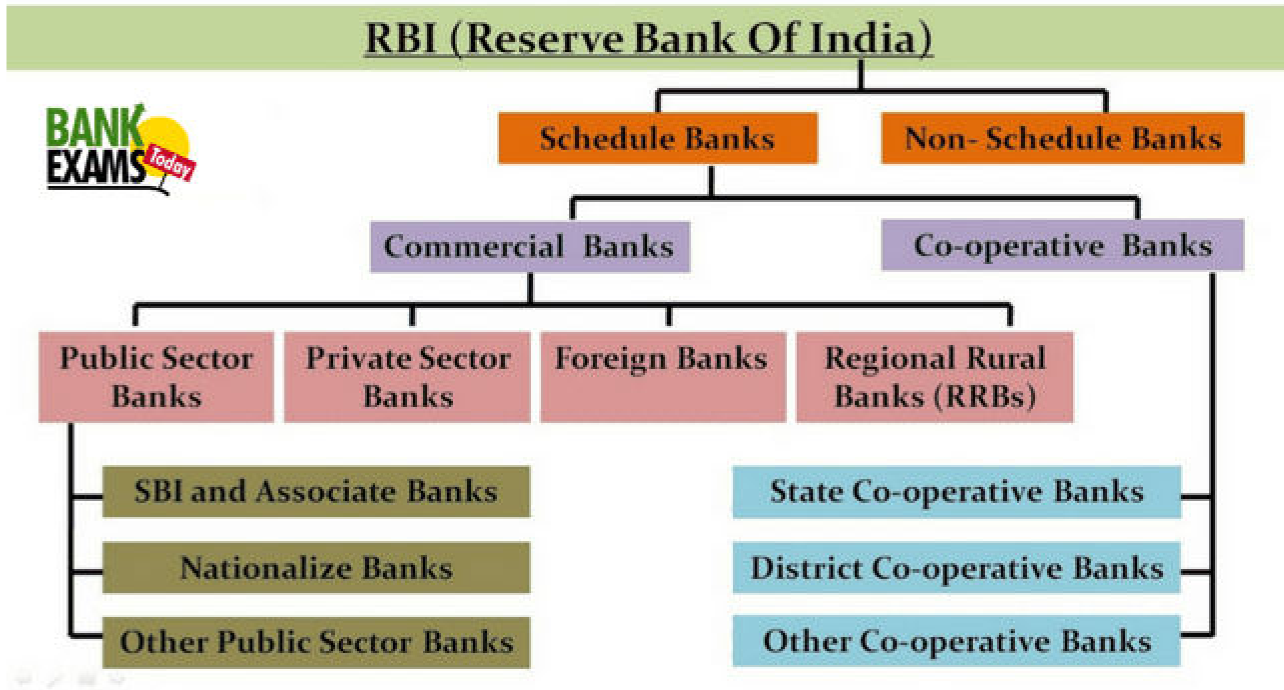

The objective is to maintain the wealth of banks in particular and to ensure the soundness of the financial system in general. It allows much greater scope for the free play of market forces than what is permitted by economic regulations alone.

On the basis of recommendations of the Committee on Banking Sector Reforms, April 1998 (the second Narasimhan Committee) the RBI issued prudential norms. The major objective of setting such norms was to ensure financial safety, soundness and solvency of banks. These norms are directed toward ensuring that banks carry on their operations as prudent entities, are free from undue risk-taking, and do not violate banking regulations in pursuit of profit.[5,6]

The main focus of reforms was in three areas:
(i) NPAs,

(ii) Capital adequacy, and

(iii) Diversification of operations,

(i) Non-Performing Assets (NPAs):
One serious problem faced by the public sector banks in the 1990s was a high proportion of NPAs. An NPA is an asset from which income is overdue for more than six months. According to the second Narasimhan Committee report (1998), "No other single indicator reflects the quality of assets and their impact on banks' viability than the NPA figures in relation to advances."

II. DISCUSSION

A firm is getting too little credit if the marginal product of capital in the firm is higher than the rate of interest the firm is paying on its marginal rupee of borrowing. Under-lending therefore is a characteristic of the entire financial system: the firm has not been able to raise enough capital from the market as a whole. In other words, while we will focus on the clients of a public sector bank, if these firms are getting too little credit from that bank, they should in theory have

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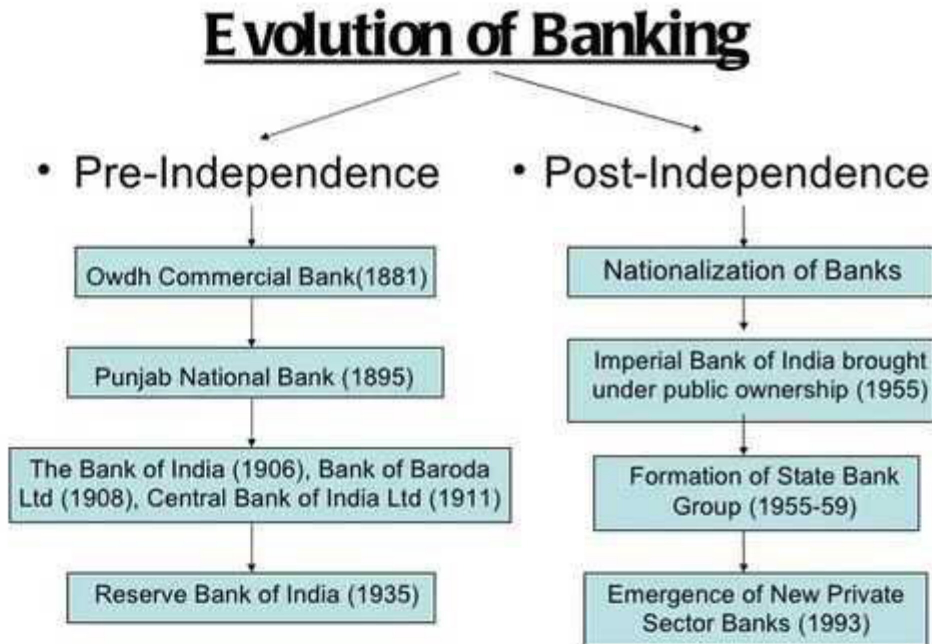
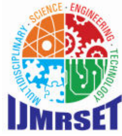
the option of going elsewhere for more credit. If they do not or cannot exercise this option, the market cannot be doing what, in its idealized form, we would have expected it to do.



Our identification of credit constrained firms is based on the following simple observation: if a firm that is not credit constrained is offered some extra credit at a rate below what it is paying on the market, then the best way to make use of the new loan must be to pay down the firm's current market borrowing, rather than to invest more. This is because, by the definition of not being credit constrained, any additional investment will drive the marginal product of capital below what the firm is paying on its market borrowing. It follows that a firm that is not facing any credit constraint will expand its investment in response to additional subsidized credit becoming available, only if it has no more market borrowing. By contrast, a firm that is credit constrained will always expand its investment to some extent. A corollary to this prediction is that for unconstrained firms, growth in revenue should be slower than the growth in subsidized credit. This is a direct consequence of the fact that firms are substituting subsidized credit for market borrowing. Therefore, if we do not see a gap in these growth rates, the firm must be credit constrained. Of course, revenue could increase slower than credit even for non-constrained firms, if the technology has declining marginal return to capital. [7,8] As mentioned above, an important rationale for the Indian bank nationalizations was to direct credit towards sectors the government thought were underserved, including small scale industry, as well as agriculture and backward areas. Ownership was not the only means of directing credit: the Reserve Bank of India issued guidelines in 1974, indicating that both public and private sector banks must provide at least one-third of their aggregate advances to the priority sector by March 1979. In 1980, it was announced that this quota would be increased to 40 percent by March 1985. Sub-targets were also specified for lending to agriculture and weaker sectors within the priority sector. Since public and private banks faced the same regulation, in this section we focus on how ownership affected credit allocation. The comparison of nationalized and private banks is never easy: banks that fail are often merged with healthy nationalized banks, which makes the comparison of nationalized banks and non-nationalized banks close to meaningless. The Indian nationalization experience of 1980 represents a unique chance to learn about the relationship between bank ownership and bank lending behavior. The 1980 nationalization took place according to a strict policy rule: all private banks whose deposits were above a certain cutoff were nationalized.18 After 1980, the nationalized banks remained corporate entities, retaining most of their staff, though the board of directors was replaced by nominees of the Government of India. Both the banks that got nationalized under this rule and the banks that missed being nationalized, continued to operate in the same environment, and face the same regulations and therefore ought to be



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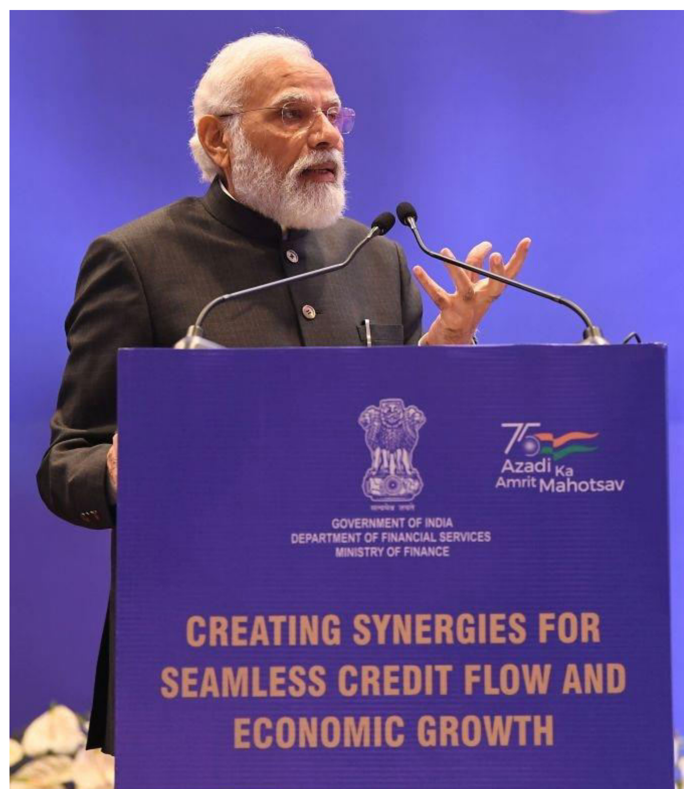
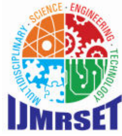
directly comparable. Even this comparison between banks just nationalized and just not nationalized may be invalid, because policy rule means that banks nationalized in 1980 are larger than the banks that remained private. If size influences bank behavior, it would be incorrect to attribute all differences between nationalized and private sector banks to nationalization.[9,10]

III. IMPLICATIONS

Digitalization in Banking Industry Digitalization in banking industry means services rendered by bank which can be available Fund Transfer•online. Indian banking industry introduces various fund transfer option to make the transaction easy.



NEFT, RTGS and Electronic fund transfer facility is given to the client for transfer of money. Most of the large companies and government organizations are using Electronic clearing services through which they Tele Banking•can make bulk payment to multiple parties. Banks have started Tele banking services under which services are provided through telephone. Digital Wallet Technology•Chat boats are used for solving number of queries and phone banking executive handle other queries. Bank will issue magnetically encoded credit & Debit card to make fund transfer from the customer to business. Digital wallet technology enable customer to electronically debit certain amount from his account and credit to another party. Pay tm, Phone Pe, Mobikwik etc are common wallet now a Automatic Teller Machines•days. Government is also encouraging cashless Transactions. [9,10] ATMs are the most widely use in banking services Presently, ATMs not only allow a person to withdraw cash at any time, but also allow an individual to pay their bills, transfer funds between different accounts etc. Prospect of Banking Technology In future data science can be use to predict the needs of customers and banks will provide•The future of indian banking sector depends on future banking technology. There will be change in the banking process in future we can see high tech services in banking•services to the customers at anytime they need. Password and OTPs are in present use for banking services now we can look forward to•sector which makes the work anyone very easy. advance Biometric authentication , Voice recognition & Banks will adopt block chain technology in which the account details of a customer will be•Face recognition in future. maintained in real-time across banks while reducing the risk of hacking by criminals. Financial transactions become encrypted packets called blocks and added to an encrypted chain, As RBI is building up around



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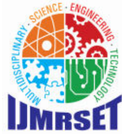
2000 branches all over the country. Fresher does can get the•something like an email chain. RBI will think about timings for banking sector.

It will be 9AM to 3PM•advantage of such decisions. The future of banking sector is bright because we have seen them take on smart technology, innovate its use, and improve the customer services with digitalization. Recent developments in the banking sector give strength in the growth of banking sector in our country. Success Mantra of Banks in Future The structure of India's banking industry would be completely different from the present. The• strength required to compete as an independent bank, are going up smartly & sharply. Banks can also improve their business for customers by providing them Deep connection with accounting software's. A banking system connected with the accounts of different clients Banking sector will adopt best practices in corporate governance and corporate social•monitor the cash flow of the clients for giving them credit. This work is totally paperless. Web page of banks should be informative and easy for customer to access so customer will get•responsibility to create their image in the mind of international investors. Bank will give information to educated customers about security so customer has more faith in•information from the webpage of the banks easily. Number of users for internet banking increase day by day because Android mobile technology is•their mind about digital security and online transactions. now common for each and every people of our country so bank will more focus on digitalization Bank will develop monitoring and feedback system to make instant feedback and to handle•in every work to get success in next coming years. queries of customers effectively. Now a day's banks will focus on retaining their existing customers and providing them exclusive services to get more and more customers in future. The public sector unit focuses on transparent and robust online mechanism with automated monitoring. Now our country will made the reforms in core areas of services related to banking and becomes top most sectors in the world so every customer will get benefit of such high tech services

IV. RESULTS

For the past three decades India's banking system has several outstanding achievements to its credit. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country.

Since the process of liberalization and reform of the financial sector were introduced in 1991, banking sector has undergone major transformation. The underlying objectives of the reform were to make the banking system more competitive, productive and profitable. Indian banks especially the public sector banks and the old private sector banks are lagging far behind their competitors in terms of both productivity and profitability with the exception of the State Bank of India and its associates. The other public sector banks and old private sector banks need to go for the major transformation program for increase their productivity and profitability.



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After studying banking reform process it can be suggested that the public sector banks must create strategic alliance with the rural regional banks to open up rural branches and increased use of technology for improved products and services for the same.

The equity market reforms of the 1990s helped improve the first three functions. The market capitalisation of the CMIE (Centre for Monitoring the Indian Economy) COSPI (CMIE Overall Share Price Index) increased from Rs. 2.3 trillion in 1990-91 to a whopping Rs. 204.5 trillion in 2020-21. The number of listed companies have gone up from 2,365 to 5,235. [11,12]

Contrast this with the record of banking reforms. As a percentage of GDP (gross domestic product), bank credit and deposits grew in the 1990s and also in the first decade of the 2010s, but since then the growth has slowed down and in the last few years, it has almost stagnated . Bank credit as a percentage of GDP has remained around 50% for almost a decade now. Repeated phases of high NPAs (non-performing assets) suggest that the sector has not developed resilience to deal with economic cycles. In terms of efficiency gains, the decade of 2000 to 2010 saw some gains, especially in the PSBs, but these gains stalled, and in fact have reversed in the last couple of years .

Continued concerns about financial inclusion expressed by the RBI and other policymakers, and the recent launch of several government schemes such as Jan Dhan Yojana[1] and Mudra[2], suggest that access to banking has not improved for low-income households and micro and small enterprises.

Recently, the central government has taken steps to merge several weaker PSBs with existing relatively stronger PSBs. It has been claimed that this reform measure will help to strengthen the banking sector that has been struggling with stressed balance sheets for close to a decade. It is not clear which of the functions outlined above will improve as a result of this policy action.

In order to improve the performance of the banking sector, reforms must be targetted not only at fixing the banking firms themselves but also amending the regulatory framework and fixing the loopholes therein – including in the legal foundations of banking and the banking regulator, that is, the RBI. While the government introduced several reforms regarding the functioning of PSBs, the Nationalisation Act of 1969 remains the operative law for them. This, in turn, limits the RBI's ability to regulate them and create a level playing field along with the non-PSBs. Even the Banking Regulation Act enacted in 1948 has not undergone any comprehensive overhaul. In contrast, the equity markets reforms were accompanied by comprehensive legal and regulatory changes. Arguably, one of the reasons the equity market reforms proved to be successful was because the entire system was transformed as opposed to narrow parts of it.

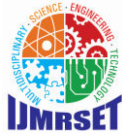
In other words, while the banking sector has grown organically in size over the last few decades, it is hard to conclude that it has improved meaningfully on any of the aspirational attributes.

On the other hand, with the insolvency reforms, while the legal foundations were properly put in place with the enactment of IBC, 2016 the institutions required to support bankruptcy resolution were not paid attention to, unlike, for example, the equity market reforms where multiple institutions were set up throughout the 1990s in order to facilitate the transformation.

The government has now set up a bad bank (National Asset Reconstruction Company Limited) to help resolve the NPAs of the banking sector and this is considered an important reform. Other than shifting the NPAs to a different balance sheet, it is not clear what new capability has been built into its design. It is like any other asset reconstruction company (ARC) collectively owned by the banks and with a bit of government support (through guarantees) thrown in. It is likely that it would face the same challenges that current ARCs are facing and on account of which these have not been able to make a significant impact on NPA resolution. Moreover, with problems in the IBC set-up, it is not clear which of the attributes will be addressed through this bad bank reform, and in which specific function of the financial system.

V. CONCLUSIONS

The banking sector is the heart of all the economic activity of a country and a small change in its regulation affects the entire economy.



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The example we all have seen is demonetization and how it influenced every one of us. In this article, we are going to discuss all the major Banking sector Reforms took place in India.

The banks are the institutions that impinge on the economy and affect their performance for better or worse. The banking system helps in

- Capital accumulation
- Growth by encouraging savings
- Mobilising the capital
- Allocating the capital for alternative uses, etc.

Asset quality has shown a significant improvement over the years in all the groups of the banks. Therefore, it can be concluded that banking reforms have indeed transformed Indian banks into strong, stable, profitable and prosperous entities. Indian banking system can now claim that their NPA levels are of international standards, with prudential provisioning, classification and an adequate capital base. But effective cost management, recovery management, technological intensity of banking, governance and risk management, financial inclusion are the areas, which will have a key bearing on the ability of Indian banks to remain competitive and enhance soundness. In this paradigm, improvement in policy framework, regulatory regime, marketperceptions, and indeed, popular sentiments relating to governance in banks need to be on the top of the agenda to serve the society"s needs and realities while being in harmony with the global perspective.[13,14]

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